No. 94-618

(3)

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In The

Supreme Court of the United States

October Term, 1994

STATE OF IOWA, TERRY E. BRANSTAD AND IOWA FRANCHISEE ASSOCIATION,

Petitioners,

vs.

HOLIDAY INNS FRANCHISING, INC., HOLIDAY INNS, INC. and McDONALD'S CORPORATION,

Respondents.

On Joint Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF IN OPPOSITION OF RESPONDENTS HOLIDAY INNS FRANCHISING, INC. AND HOLIDAY INNS, INC.

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QUESTIONS PRESENTED

1. Did the Eighth Circuit and the District Court follow the well-established Contracts Clause analysis in holding the public purpose of the Iowa Franchise Act, which is to equalize bargaining power and redistribute rights between private contracting parties, insufficient to allow it to be applied retroactively to restructure Holiday Inns' rights under its pre-existing License Agreements?

2. Did the Eighth Circuit follow the Contracts Clause analysis prescribed by existing Supreme Court precedent in affirming the District Court's holding that the Iowa Franchise Act substantially impairs the contractual rights allocated in Holiday Inns' pre-existing License Agreements?

3. Did the Eighth Circuit follow established Contracts Clause analysis in concluding that the Iowa Franchise Act regulated an area of business not sufficiently regulated previously so as to allow Iowa to restructure the rights and expectations of the parties under Holiday Inns' pre-existing License Agreements?

PARTIES TO PROCEEDINGS

Petitioners are the State of Iowa; Terry E. Branstad, Governor of the State of Iowa; and the Iowa Franchisee Association.

Respondents are Holiday Inns Franchising, Inc., Holiday Inns, Inc. and McDonald's Corporation.

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BRIEF IN OPPOSITION OF RESPONDENTS HOLIDAY INNS FRANCHISING, INC. AND HOLIDAY INNS, INC.

Respondents Holiday Inns Franchising, Inc. and Holiday Inns, Inc. respectfully pray that this Court deny Petitioners the State of Iowa, Terry E. Branstad and the Iowa Franchisee Association's Joint Petition for Writ of Certiorari and decline to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered on July 7, 1994.

OPINIONS BELOW

Joint Petitioners the State of Iowa, Terry E. Branstad, and the Iowa Franchisee Association have correctly set forth the citations to the opinions of the United States Court of Appeals for the Eighth Circuit and the United States District Court for the Southern District of Iowa, Central Division, and have attached true and correct copies of those opinions to their Joint Petition for Writ of Certiorari.

STATEMENT OF JURISDICTION

Respondents Holiday Inns Franchising, Inc. and Holiday Inns, Inc. concur in the Joint Petitioners' statement of jurisdiction. There is no dispute among the parties concerning the jurisdiction of this Court properly to consider and decide the timely-filed Joint Petition for Writ of Certiorari.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Joint Petitioners the State of Iowa Terry E. Branstad and the Iowa Franchisee Association have correctly set forth the citations and relevant language of the constitutional provisions of the United States Constitution and of the Constitution of the State of Iowa. Further, Joint Petitioners have properly attached true and correct copies of the relevant portions of the challenged statute of the State of Iowa, the Iowa Franchise Act (Iowa Code Chapter 523H) to their Joint Petition for Writ of Certiorari.

STATEMENT OF THE CASE

The day after its becoming effective, Holiday Inns Franchising, Inc. and Holiday Inns, Inc. (collectively "Holiday Inns") filed an action in the United States District Court for the

Southern District of Iowa, Central Division, challenging the constitutionality of Iowa Code Chapter 523H (the "Iowa Franchise Act" or the "Act"). Holiday Inns named Iowa Governor Terry E. Branstad as a defendant in the action, along with two of its franchisees. At approximately the same time McDonald's Corporation filed a lawsuit challenging the same statute. The Iowa Franchisee Association intervened in both actions.

The Iowa Franchise Act is the most restrictive franchise relationship statute ever enacted. Although several other states have passed legislation regulating various aspects of the franchisor-franchisee relationship, the Iowa Franchise Act goes far beyond the other statutes to restructure completely the fundamental contractual relationship and bargained-for rights of franchisors and franchisees, and even attempts, unlike any other general franchise relationship statutes, to apply retroactively to *existing* franchise agreements. Iowa Code § 523H.2.

Holiday Inns filed a motion for partial summary judgment claiming that retroactive application of at least four provisions of the Act constitutes a substantial impairment of Holiday Inns' existing franchise agreements. The four provisions involve transfer (Iowa Code § 523H.5), encroachment (Iowa Code § 523H.6), termination (Iowa Code § 523H.7), and renewal (Iowa Code § 523H.8). McDonald's filed a similar motion for partial summary judgment challenging the constitutionality of the retroactive application of the same provisions of the Act. All Petitioners resisted the motions, and the State of Iowa and Governor Branstad filed a cross-motion for summary judgment which was resisted by Holiday Inns. The District Court consolidated the two cases for purposes of considering the motions for partial summary judgment and entered one consolidated order.

The District Court, in a thorough and well-reasoned opinion,

held that the application of the challenged provisions of the Iowa Franchise Act to pre-existing contracts violates the Contracts Clauses of the United States and Iowa Constitutions. The District Court separately analyzed each of the challenged statutory provisions and compared each such provision against the relevant section of Holiday Inns' and McDonald's existing contracts with their franchisees. After analyzing the effect of the Act on the relevant contractual provisions, the District Court held that the rights and expectations of the parties to the existing franchise agreements would be materially altered by the statute. (App. 12-22). The District Court further determined that the Act's public purpose to adjust the balance of power between private contracting parties is insufficient to justify the substantial impairment which the Act's provisions have on Holiday Inns' pre-existing License Agreements. (App. 34).[1] The District Court immediately certified the issue for appeal to the Eighth Circuit Court of Appeals.

In reviewing the District Court opinion, the Eighth Circuit held: "The district court, in a detailed and well-considered opinion, held that the retroactive application of these provisions violated both the Iowa and United States Constitutions. . . . We affirm the district court." (App. 4).[2] While the Eighth Circuit provided a more detailed review of one aspect of Contracts Clause jurisprudence, it essentially affirmed based on its agreement with the analysis and conclusions in the District

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1 Accordingly, the District Court did not reach the last step of Contracts Clause analysis to determine whether the Act's restructuring of the contractual rights of the parties is based on reasonable conditions and of a character appropriate to any public purpose. (App. 34).

2 As is true with all federal courts of appeal, the Eighth Circuit maintains Local Rule 47B to allow it simply to affirm a decision of the district court, in its discretion, with or without further explanation by stating simply: "AFFIRMED. See 8th Cir. R. 47B."

Court's opinion, stating: "[w]e therefore do not see that any useful purpose would be served by a re-examination of the applicable legal principles so ably canvassed and applied by the district court." (App. 4).

Far from departing in any way from established Contracts Clause analysis, the Eighth Circuit, by adopting in full the District Court's thorough, well-reasoned and analytically sound decision, exercised full and appropriate review of the retroactive application of the Iowa Franchise Act and correctly found it to violate the Contracts Clauses of the United States and Iowa Constitutions.

REASONS FOR DENYING THE WRIT

The Joint Petition in this proceeding fails to satisfy *any* of the criteria traditionally applied by this Court in determining whether to grant a writ of certiorari. As Joint Petitioners note, the three-step Contracts Clause analysis has been well-established by this Court: first, a court must determine whether the challenged statute substantially impairs existing contractual rights; second, if substantial impairment is found, the court must review the public purpose of the statute; and third, the court must determine whether the adjustment in contractual rights of the parties is based on reasonable conditions and is of a character appropriate to the public purpose. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-45 (1978); *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-12 (1983). Joint Petitioners claim that the Eighth Circuit Court of Appeals has disregarded this long-established standard of analysis. But, a closer review of the Eighth Circuit opinion reveals that the Court of Appeals adopted the well-reasoned and thorough opinion of the District Court and that Joint Petitioners' criticism is misplaced. The Eighth Circuit need not rewrite nor reiterate a decision of the lower court which it affirms and adopts in whole.

No other reason exists to grant Joint Petitioners' Petition for Writ of Certiorari: there is no split in the decisions of the federal courts of appeal or between a court of appeal and a state court of last resort; the Eighth Circuit has *not* decided this matter in conflict with existing Supreme Court decisions; and the Eighth Circuit has not so far departed from accepted judicial proceedings to require review by the Supreme Court. The Eighth Circuit affirmed a District Court opinion which carefully and exhaustively followed the well-established Contracts Clause analysis and correctly found the Iowa Franchise Act to violate the Constitutions of both the United States and of the State of Iowa. The Joint Petition therefore should be denied.

I.

THE IOWA FRANCHISE ACT SERVES NO SIGNIFICANT OR LEGITIMATE PUBLIC PURPOSE SUFFICIENT TO APPLY ITS PROVISIONS RETROACTIVELY.

It is important to note initially that there is no significant dispute between Holiday Inns and the Joint Petitioners, either here or in the courts below, as to the proper framework for analyzing this Contracts Clause question.[3] The relevant issue here is whether the Eighth Circuit actually performed this Contracts Clause analysis in affirming the opinion of the District Court without restating the analysis used by the District Court. Because the Eighth Circuit adopted in full the analysis and conclusions of the District Court, the Eighth Circuit was not required to issue its own lengthy opinion in order to affirm the lower court.

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3 All parties further agree that the analyses are identical for constitutional challenges under the United States and the Iowa Constitutions.

Joint Petitioners claim that the Eighth Circuit did not consider the public purpose of the Act and, thus, failed to apply the legal standard mandated by this Court. This argument is incorrect. The Eighth Circuit did review and affirm the opinion of the District Court which included a thorough analysis of the public purpose issue. The appellate court did not have to repeat that opinion word for word.

Joint Petitioners have raised no issue concerning the Eighth Circuit's and the District Court's review of the public purpose of the Act sufficient for this Court to grant a writ of certiorari. The District Court, having found that the Iowa Franchise Act substantially impairs pre-existing Holiday Inns License Agreements, further determined that the Act fails the second step of the *Allied Structural Steel* test because it serves no significant or legitimate public purpose and is merely special-interest legislation. (App. 34). *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978); *Energy Reserves*, 459 U.S. at 411-12. The District Court expressly considered the evidence presented by affidavit and in the legislative history of the Act concerning its purported purpose and found that the State had not shown a sufficient public purpose to allow retroactive application of the Act. (App. 31-32). The Eighth Circuit affirmed that decision. (App. 4).

In deciding that the public purpose of the Act was insufficient to sustain retroactive application to existing contracts, the District Court cited numerous Supreme Court precedents as well as precedents from other federal and state courts. *See, e.g., Allied Structural Steel*, 438 U.S. at 234; *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977). The District Court applied precisely the test articulated by those courts. It did not weaken or alter the standard in any way. The simple fact that the Eighth Circuit did not restate the District Court's exhaustive

analysis does not mean that the appellate court applied a weaker standard.[4]

The District Court correctly found that the purpose of the Act is to equalize bargaining power and contractual rights between franchisees and franchisors. The question presented to this Court is whether the Eighth Circuit and the District Court disregarded existing precedent in holding that this purpose was not sufficient to justify applying the Act retroactively to substantially impair Holiday Inns' existing License Agreements.

Readjusting private contractual rights for the benefit of a limited class of persons, such as franchisees, is *not* a legitimate public purpose sufficient to justify retroactive application of the Iowa Act. *See, e.g., Chico's Pizza Franchises, Inc. v. Sisemore*, 544 F. Supp. 248, 249-50 (E.D. Wash. 1981), *aff'd without opinion*, 685 F.2d 440 (9th Cir. 1982). Joint Petitioners have cited no case authority that such a purpose is sufficient to sustain retroactive application of a statute that substantially impairs existing contractual rights, as opposed to prospective economic regulation.[5] The test of the public purpose employed in cases

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4 Accordingly, Joint Petitioners are incorrect in claiming that the Eighth Circuit has adopted a form of "strict scrutiny" for any legislation which impairs existing contracts. As the District Court pointed out, the level of scrutiny to which the public purpose of a statute will be subjected is directly related to the severity of the impairment of the contractual rights of the parties. (App. 26) (citing *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983)). Because the challenged provisions of the Act radically alter Holiday Inns' rights under its pre-existing License Agreements, the level of scrutiny applied by the District Court and affirmed by the Eighth Circuit was entirely appropriate.

5 Joint Petitioners cite to several law review articles which list and discuss the various franchise laws across the country. Significantly, none of the various general franchise laws across the country has encroachment or such

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involving retroactive application of a statute is more stringent than in those involving prospective application. The State of Iowa must show that the Act has a "significant and legitimate" public purpose in order to apply it retroactively, not just that the Act is rationally related to the alleged governmental interest. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-12 (1983). The analysis in cases involving prospectively applied statutes is more deferential than the "public purpose" prong of the Contracts Clause analysis and is more analogous to the final phase of the analysis, *i.e.*, whether the challenged statute is rationally drawn to meet the purpose being advanced.

One federal court of appeals has concluded that "a state's interest in righting a bargaining imbalance, standing alone, is not sufficient" to allow *prospective* regulation of a private business relationship. *Allied Artists Picture Corp. v. Rhodes*, 679 F.2d 656, 665 (6th Cir. 1982). If equalizing a bargaining imbalance is not a legitimate purpose to justify such *prospective* regulation, it is surely insufficient to justify direct impairment of Holiday Inns'

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restrictive transfer provisions. Moreover, the franchise laws of all states except Delaware and Washington do not purport to apply retroactively. The franchise laws of Delaware and Washington apply retroactively only to imply a requirement of good faith and fair dealing into all contracts, including franchise agreements, and to require notice before termination, as otherwise required by common law. Del. §§ 2552, 2554 and 2555; Wash. § 19.100.910.

Further, Joint Petitioners cite to *Modern Computer Systems, Inc. v. Modern Business Systems, Inc.*, 871 F.2d 734, 739 (8th Cir. 1989), as though it supports the notion that franchisors generally take advantage of franchisees. A complete reading of the language quoted by Joint Petitioners demonstrates that although the court recognized that franchising literature reports numerous instances of abuse by franchisors, "we do not believe that the facts in this case fit that stereotype." *Id.* The court indicates that some specific evidence of abuse must be found to disregard the mutually agreed-upon contract language.

pre-existing contractual rights.[6] The District Court therefore correctly concluded that the Act has no significant and legitimate public purpose and that its retroactive application is unconstitutional.

As the District Court pointed out, the State of Iowa needed to have shown that the public purpose behind the Act was to remedy "a broad and general social or economic problem. The requirement of both a significant and legitimate public purpose 'guarantees that the State is exercising its police power, rather than providing a benefit to special interests.' " (App. 31) (quoting *Energy Reserves*, 459 U.S. at 412). Cases sustaining the retroactive application of a state statute against Contracts Clause challenges have required the statute not to "prescribe a rule limited in effect to contractual obligations or remedies, but instead [to] impose a generally applicable rule of conduct designed to advance 'a broad societal interest.' " (App. 33) (quoting *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983)). *See, e.g., Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502-05 (1987) (state had strong public interest in legislation regulating environmental effects of mining operations on landowners).

Joint Petitioners cite three cases as analogous federal and state court decisions with which the Eighth Circuit's decision here allegedly conflicts. None of these opinions is directly on point. First, *Troy Ltd. v. Renna*, 727 F.2d 287 (3d Cir. 1984), involved a statute which merely enlarged a pre-existing tenancy which came into operation as a matter of law. Thus, the statute

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6 Regarding the equalization of bargaining power between parties, this Court should note that it is manifestly impossible for any government action to equalize the bargaining power between parties to a pre-existing agreement. The bargaining is completed; the agreement has been reached. Therefore, equalizing bargaining power cannot be a significant and legitimate public purpose to sustain retroactive application.

did not impair the parties' contractual rights at all. Further, the purpose of the act was to protect the mental and physical health and safety of senior citizens by preventing their relocation or eviction, which obviously is a more significant and generally applicable public purpose than readjusting the rights of private contracting parties.

Second, *Schieffelin & Co. v. Department of Liquor Control*, 479 A.2d 1191 (Conn. 1984), involved a change in the regulation of the notice requirement for termination of liquor distributorships. Third, *Anderson's Vehicle Sales, Inc. v. OML-Lincoln*, 287 N.W.2d 247 (Mich. 1979), involved notice and good cause requirements imposed on automobile dealership agreements as a codification of the common law governing contracts. The industries regulated by the new statutes in *Schieffelin* and *Anderson* are universally recognized as sufficiently highly-regulated to forewarn those parties that further regulation is likely. As the courts below correctly noted, neither franchising in general nor the hotel industry in particular fits that characterization.

The Eighth Circuit's affirmance of the District Court's opinion is in line with decisions of other federal courts of appeal and state courts of last resort which almost uniformly have stricken down retroactive application of franchise statutes supported by public purposes similar to the one here. *See Chico's Pizza Franchises*, 544 F. Supp. at 248 (E.D. Wash. 1981), *aff'd without opinion*, 685 F.2d 440 (9th Cir. 1982) (the court declared unconstitutional the Washington Franchise Investment Protection Act because its purpose did not justify retroactive application); *Jacobsen v. Anheuser-Busch, Inc.*, 392 N.W.2d 868 (Minn. 1986) (the Minnesota Supreme Court refused to allow retroactive application of a statute which benefitted wholesale beer distributors finding it special interest legislation without sufficient legitimate public purpose), *cert. denied*, 479 U.S. 1060

(1987); *Wipperfurth v. U-Haul Co.*, 304 N.W.2d 767 (Wis. 1981) (the Wisconsin Supreme Court struck down the retroactive application of a state automobile dealership franchise law because it was not necessary to the vital interests of the people of the State).

In reviewing the public purpose of the Act, the District Court and the Eighth Circuit meticulously followed the Contracts Clause analysis prescribed by the Supreme Court and followed by other federal and state courts. The District Court found that the stated public purpose was insufficient to allow retroactive application of a statute that so substantially impaired the rights articulated in existing Holiday Inns License Agreements. The Eighth Circuit affirmed that conclusion. Although Joint Petitioners may not be satisfied with the outcome of the District Court's review, they articulate no reasons to justify this Court's grant of a Writ of Certiorari.

II.

THE EIGHTH CIRCUIT PROPERLY AFFIRMED THE DISTRICT COURT'S CONCLUSION THAT THE IOWA FRANCHISE ACT SUBSTANTIALLY IMPAIRS THE CONTRACTUAL RIGHTS IN HOLIDAY INNS' EXISTING LICENSE AGREEMENTS.

The starting point to determine whether a challenged statute violates the Contracts Clause of the Constitutions of the United States or the State of Iowa is whether the statute in question substantially impairs the existing rights of parties to an actual contract. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-45 (1978). Joint Petitioners and Holiday Inns agree that in order to determine whether contractual rights have been substantially impaired, a court must first review the contractual rights at issue and the nature of the impact of the statutory

provisions on those rights. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 504 (1987). The factors to be weighed in making this assessment include the severity of the impairment, the extent to which the challenged statute frustrates a party's reasonable expectations, and the extent to which the subject matter of the impairment has been regulated in the past. *Allied Structural Steel*, 438 U.S. at 245-46. The District Court followed this step of Contracts Clause analysis and thoroughly reviewed the nature and extent of the impairment of Holiday Inns' contractual rights under its License Agreements caused by the challenged statutory provisions of the Act.

The District Court further noted that the level of scrutiny with which it reviews a statute is determined by the extent to which the contractual rights of the parties are impaired. " 'The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected. Total destruction of contractual expectations is not necessary for a finding of substantial impairment.' " (App. 26) (quoting *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983) (citation omitted)). Joint Petitioners overstate the degree of impairment required to satisfy this first prong of the Contracts Clause test, implying that the State has virtually unlimited police power to alter private contracts by regulation. Where, as here, a statute creates new rights for one party while substantially restricting or even eliminating the existing rights of the other party, a substantial impairment must be found to exist and the District Court properly so held.

Moreover, Joint Petitioners mischaracterize the real issue in the substantial impairment analysis. The issue in determining whether the Act substantially impairs Holiday Inns' contracts is *not* whether the Act totally prohibits Holiday Inns from engaging in certain conduct, such as terminating or refusing to renew a franchisee, in the abstract. The issue instead is whether the

restrictions in the Act impair or abrogate significant rights Holiday Inns possesses under its pre-existing License Agreements. The District Court correctly decided this issue, and the Eighth Circuit affirmed that the Act does substantially impair Holiday Inns' contractual rights.

Joint Petitioners take issue with the fact that the Eighth Circuit's discussion of the substantial impairment issue consists of a "reference to" the District Court's finding of substantial impairment. Such reference, however, is both appropriate and sufficient. The District Court undertook a detailed review of the contractual relationship between Holiday Inns and its franchisees. (App. 12-22). The District Court analyzed the nature and importance of the contractual clauses from Holiday Inns' License Agreements that were effected by the challenged provisions of the Act. (App. 12-22). The District Court evaluated the impact the Act has on Holiday Inns' contractual rights, and determined that the Act impaired the contractual relationship to a substantial degree. (App. 15-31). While Joint Petitioners may not agree with the outcome of that analysis, they cannot deny that the District Court undertook such analysis and employed the proper legal framework. The Eighth Circuit's adoption and affirmance of the District Court's reasoning and conclusion that the Act impairs Holiday Inns' pre-existing contracts is both appropriate and, under these circumstances, absolutely correct.

The Eighth Circuit clearly was not required to issue its own opinion engaging in a lengthy Contracts Clause exposition which merely parroted the District Court's analysis. Joint Petitioners' argument that the Eighth Circuit should have done just that offends judicial economy and common sense. Such an argument certainly provides no basis for granting certiorari in this case.

Joint Petitioners also incorrectly contend that the Eighth Circuit should have required Holiday Inns "to demonstrate the

extent" to which the Act modified Holiday Inns' rights by providing evidence that Holiday Inns intended eminently to exercise those rights. Joint Petitioners suggest that requiring Holiday Inns to prove that it had planned either to terminate or refuse to renew its franchise agreements is consistent with the incremental "approach to assessment of 'substantial impairment'" adopted in *General Offshore Corp. v. Farrelly*, 743 F. Supp. 1177 (D.V.I. 1990).

To the extent *General Offshore* even states the appropriate standard of analysis, it is readily distinguished from the situation here. The *General Offshore* court found it significant that local case law had *already* restricted the right of an employer to terminate an employee at will. The plaintiff in that case contended that its right to discharge employees was substantially impaired by a statute which provided a list of circumstances under which an employer *could* terminate an employee. *Id.* at 1197-98. The court there also noted that an employer and employee were "free to contract around the statute by creating additional reasons for discharge," which further mitigated the effect of the statute, but that the statute did not absolutely prohibit discharge. *Id.* at 1199 n.17.

Neither the rationale of *General Offshore* nor the interpretation of it urged by Joint Petitioners is applicable here. Iowa case law has not previously restricted Holiday Inns' ability to exercise its relevant rights under its License Agreements. Further, Holiday Inns cannot preserve or resurrect its pre-existing contractual rights by entering into a new agreement with its franchisees after the provisions of the Act take effect. Thus, *General Offshore* does not support the constitutionality of the Act's retroactive application. More importantly, existing Contracts Clause jurisprudence from this Court clearly does not require Holiday Inns to prove that it planned eminently to

exercise its pre-existing contractual rights before a substantial impairment may be found.[7]

In sum, the Eighth Circuit affirmed that the District Court properly applied the appropriate legal principles, stating:

> We do not think it can be seriously contested that the retroactive feature of the relevant Iowa legislation substantially impaired the obligations previously owed to the plaintiffs in this case, or that this dispute is ripe for adjudication. We therefore do not see that any useful purpose would be served by a re-examination of the applicable legal principles so ably canvassed and applied by the district court.

(App. 4).[8] Under the undisputed facts of this case, this decision is clearly correct. Because the courts below both applied the proper Contracts Clause analysis and reached the proper result, this Court should deny the Joint Petition for Writ of Certiorari.

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7 Joint Petitioners' contention that Holiday Inns was required to demonstrate to the District Court and to the Eighth Circuit that it intended to exercise the rights it possessed under its contracts appears to raise an issue of standing or ripeness to challenge the Act. Each of those claims was raised and rejected below but have *not* been pursued here by Joint Petitioners.

8 Having thus affirmed the District Court's opinion, the Eighth Circuit simply goes on to offer observations "on a very troublesome aspect of current Contract Clause jurisprudence." (App. 4). The comments by the Eighth Circuit to clarify one aspect of Contract Clause jurisprudence do not detract from the Court's affirmance and adoption of the District Court opinion.

III.

THE CHALLENGED PROVISIONS OF THE IOWA FRANCHISE ACT COULD NOT HAVE BEEN ANTICIPATED BY HOLIDAY INNS WHEN IT ENTERED INTO ITS IOWA LICENSE AGREEMENTS.

One relevant factor in determining whether a state statute substantially impairs existing contractual rights is whether the kind of contract or relationship which is the subject matter of the dispute had been previously regulated. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 250 (1978); *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. at 400, 411 (1983). Like the District Court, the Eighth Circuit made a detailed analysis of this particular aspect of Contracts Clause jurisprudence as articulated by the Supreme Court. As the Eighth Circuit observed:

> The idea, evidently, is that if the party to the contract who is complaining could have seen it coming, it cannot claim that its expectations were disappointed. To put it in economic terms, a party's evaluation of the possibility of interference is reflected in the negotiated price, and thus the value of performance to it is not reduced, if it can more or less accurately value the risk of that interference. We believe that this is the principle that the Supreme Court is developing in its cases.

(App. 5).

The Eighth Circuit went on to note that while Iowa had enacted franchise regulation statutes in five specific (and traditionally regulated) industries, it had never attempted to

regulate franchise relationships in general or in the hotel or fast food industries in particular. Moreover, only one of those industry-specific statutes purported to be retroactive and then not generally so. (App. 5). (*See* Iowa Code Ann. §§ 322F.1-322F.9). The Eighth Circuit further noted that reference by Appellants, and here by Joint Petitioners, to statutes from other jurisdictions which they claim are similar to the Iowa Franchise Act fails from the same infirmity: those statutes do not purport to apply retroactively. (App. 6). On this point the Eighth Circuit explained in some detail its conclusion, which is identical to that of the District Court:

> It is absolutely plain, moreover, that the [retroactive] application of statutes similar to the one here, and in the circumstances that are present in this case, has almost uniformly been held unconstitutional, and this is a datum on which franchisors are presumably allowed to rely while bargaining and in fixing the prices of their licenses.

(App. 6) (citations omitted).[9]

In addition, there has *never* been any generally applicable federal regulation of franchise relationships. The only regulation at the federal level has been the Federal Trade Commission Franchise Rule, 16 C.F.R. § 436 (1994), which merely requires certain pre-sale disclosures and does not purport to regulate the post-sale relationship. Further, the fact that franchise relationship bills have been introduced in Congress certainly is not persuasive

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9 Indeed, this Court recently denied review of a ruling that retroactive application of the termination and encroachment provisions of the Ohio motor vehicle dealer law was unconstitutional. ***Men-Guer Chrysler-Plymouth, Inc. v. Chrysler Corp.***, No. 93-1806, 63 U.S.L.W. 3257 (U.S. ***cert. denied***, Oct. 3, 1994).

because the case law focuses on statutes and regulations in existence *at the time the contracts were entered into. See Energy Reserves*, 459 U.S. at 400.

Similarly, Joint Petitioners' attempt to portray the franchise industry as heavily regulated, and indeed as self-regulated, by virtue of the International Franchise Association's ("IFA") proposed Code of Ethics clearly is not persuasive. The IFA's Code of Ethics did not exist at the time Holiday Inns entered into its License Agreements nor was it even in existence at the time the Act was passed. *See* "Franchisor Self-Regulation," Bus. Franchise Guide (CCH) No. 156, at 12 (Dec. 18, 1992). Indeed, the Code of Ethics, by its own terms, was approved "[i]n the wake of the enactment of the controversial Iowa franchise law." *Id.*[10]

Joint Petitioners' attempt to rely on prior judicial precedent and common law fares no better. While courts have recognized an implied covenant of good faith in franchise agreements, as in all contracts, they have varied widely in their interpretations of the nature and scope of that duty. It is clear, however, that the implied covenant of good faith and fair dealing only governs the exercise of rights by parties to a contract where the contract grants one party discretion in performance. *See, e.g., Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 280 (7th Cir. 1992) (implied covenant imposes duty not to "tak[e] advantage of gaps in a contract in order to exploit the vulnerabilities" therein); *Hubbard Chevrolet Co. v. General Motors Corp.*, 873 F.2d 873, 876-77 (5th Cir.) (implied covenant supplies limits on parties' conduct when contract defers decision on particular term or is ambiguous), *cert. denied*, 493 U.S. 978 (1989). Moreover, implying a covenant of

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10 Moreover, the Code of Ethics has since been modified by the International Franchise Association as a "Code of Principles and Standards of Conduct" and has become something far less restrictive than initially conceived.

good faith neither creates new rights independent of the contract nor can it override the express terms of the contract. *Corenswet, Inc. v. Amana Refrigeration, Inc.*, 594 F.2d 129, 138 (5th Cir.), *cert. denied*, 444 U.S. 938 (1979); *Carlock v. Pillsbury Co.*, 719 F. Supp. 791, 812 (D. Minn. 1989). By contrast, the Iowa Franchise Act goes much farther than existing common law in that it actually nullifies existing rights under Holiday Inns' License Agreements and grants completely new rights not contemplated in the pre-existing contracts. (App. 12-22).

Further, Joint Petitioners have suggested that one prior Iowa Supreme Court case, *Midwest Management Corp. v. Stephens*, 291 N.W.2d 896 (Iowa 1980), creates common law which they claim that the Act codifies. Contrary to this assertion, *Midwest* simply repeats that terminations should not be arbitrary, *id.* at 913, while suggesting no specific regulation of franchises or franchise agreements and, in fact, without even dealing with franchises at all. Thus, prior judicial regulation by the courts of Iowa does not provide a sufficient basis to support the Act's retroactive application.

Finally, Joint Petitioners argue that the existence of legal and political commentary regarding franchise relationships should have put Holiday Inns on notice of impending regulation as drastic as the Iowa Act. Such law review articles and commentary, however, demonstrate only that franchising has been a much discussed area of law and business but does not show that it has been a highly regulated one. Joint Petitioners have provided no case authority indicating that such commentary is even relevant to the issue of prior regulation.

In sum, the Eighth Circuit completely and correctly addressed the issue of whether there has been a sufficient history of regulation of franchises in general and of the hotel industry in particular in the state of Iowa and elsewhere to justify the

imposition of the Iowa Franchise Act. Joint Petitioners do not even attempt to contend and cannot claim that they have raised an issue concerning prior regulation which would meet the criteria traditionally applied by this Court in determining whether to grant a writ of certiorari. They have not raised such issue, and the writ should be denied.

CONCLUSION

Accordingly, for all the foregoing reasons, Petitioners' request for a writ of certiorari should be denied.

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Respectfully submitted,

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